SEPTEMBER 2005 Policy Brief

OECD

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Opening Up Trade in Services: Crucial for Economic Growth

Introduction

Services, from health to banking, have become the single largest sector in many economies worldwide. They not only provide the bulk of employment and income in many countries, but they also serve as vital input, such as telecommunications, for producing other goods and services. So an efficient services sector is crucial for the overall economy. And because of this, agreement on opening up services markets is crucial to the success of the current global trade talks.

Such market opening will bring gains to all economies, including the developing world, as long as it is done in a carefully considered way. But opening up services markets is a particularly complex challenge. For one thing, any discussion of trade in services has to include the thorny question of whether people providing a service, such as nurses, lawyers or computer maintenance engineers, can go to another country to do so.

The previous round of global trade talks only achieved modest market opening agreements for services. But since then technological developments have created their own momentum. Online services such as customer call centres, for example, no longer need to be in the same hemisphere as the customer. As a result, services markets have opened up under bilateral or regional agreements, and under domestic reform programmes.

The current Doha Development Agenda (DDA) negotiations at the World Trade Organization (WTO) offer countries at all levels of development a chance to take stock of developments in the services sector so far, and undertake progressive further opening.

This *Policy Brief* summarises some of the key findings of ongoing OECD work on the benefits and challenges of liberalising services trade. ■

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Who gains from more open services trade?

The share of services in the world economy has expanded markedly in recent years, and services now account for almost 70% of production in high-income OECD countries. Services are also becoming increasingly important in middle and low income countries, at the expense of agriculture and manufacturing.

Opening up trade in services would benefit both developed and developing countries. Indeed, developing countries generally stand to make significant gains, despite a perception in much of the developing world that they will lose out because their domestic service industries are inefficient and non-competitive.

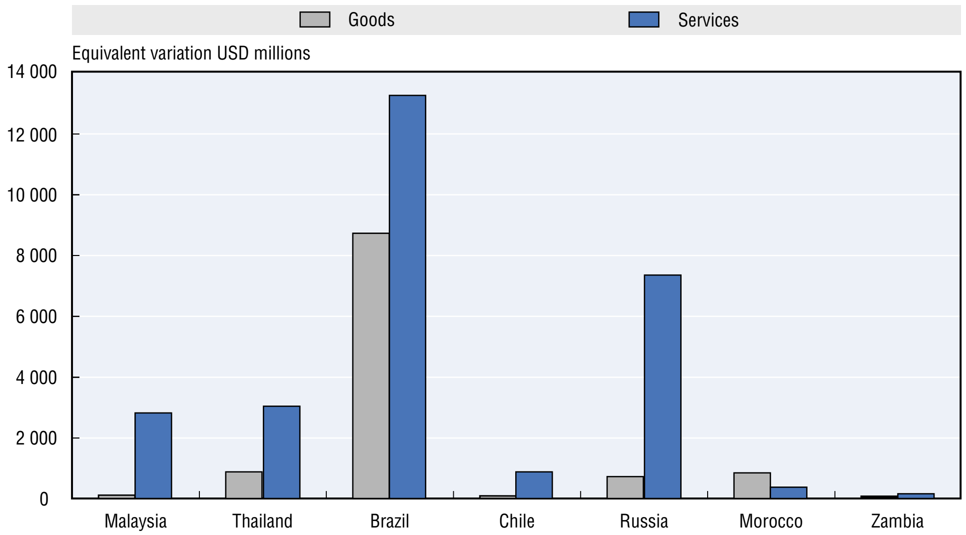
For all economies, the gains from more open services trade are substantially greater than those from liberalising trade in goods. There are several reasons for this. Levels of protection in services trade are higher than for other areas, and services are occupying an ever larger share of the economy. Also, services such as telecommunications and transport are essential for producing and delivering virtually all goods, so more open, more efficient, services markets can have a major impact on overall economic performance. Agriculture and manufacturing would benefit from improved efficiency of supply, for example, and this is likely to ease any strains these sectors may face as a result of their own market opening.

Indeed, OECD studies suggest that if countries went ahead and opened their services markets unilaterally, they would gain almost as much as under a multilateral agreement, and far more than from similar reforms in agriculture and manufacturing (see Figures 1 and 2). So there is an argument for individual countries not to wait. Nonetheless, the overall gains to the world economy would clearly be greater from multilateral market opening.

Additionally, if services barriers are considered, the effective rate of protection – which takes into account the effects of tariffs on inputs as well as on outputs – for some agricultural and manufacturing sectors actually turns negative. This means that services barriers – combined with barriers on

Figure 1:

GAINS FROM LIBERALISATION IN GOODS AND SERVICES



Source: OECD.

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other inputs – amount in effect to a tax on these industries and compound the distortions arising from barriers to trade in agricultural and manufactured goods.

The temporary movement of people to other countries to provide or deliver a service (Mode 4 of the General Agreement on Trade in Services, GATS) is a key element of more open services markets for most developing countries. Opening up this area could offer significant global economic gains, although recent OECD studies suggest that the impact could vary considerably between countries and service sectors, depending on the type and skill levels of workers involved, as well as the governing regulatory framework.

Sending service suppliers abroad can help a developing country reduce pressure on labour markets while increasing capital flows and helping build human capital. Remittances from abroad can be an important source of revenue. For example, remittances for 2004-05 in Bangladesh totalled USD 3.86 billion, representing almost 4% of GDP and one-third of gross export earnings. But there are also some risks. When skilled personnel go abroad, the sending country loses not just their skills but also the money invested in their education and training. However, these risks may be lessened by the temporary nature of Mode 4 movement.

For *receiving* countries, bringing people in temporarily to provide services can help improve competitiveness and provide short-term relief for labour market shortages. As there are likely to be some adjustment costs, Mode 4 liberalisation needs to be accompanied by appropriate regulation and domestic policies. ■

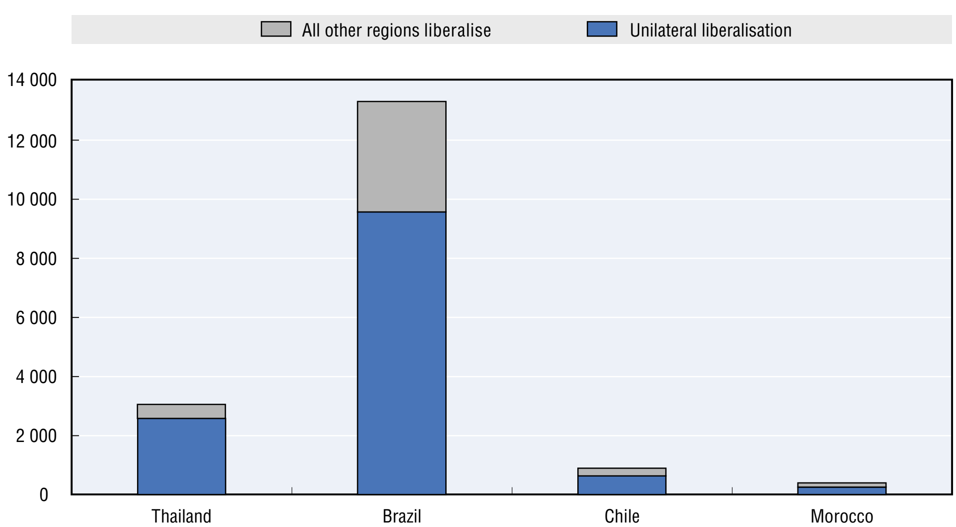
Which service exports for developing countries?

Industrialised countries still dominate global trade and investment in services, but recent OECD work shows that developing countries are becoming increasingly specialised and successful in a number of sectors.

In **audiovisual services**, the international market provides the major source of earnings for the Indian film industry, with film exports growing from

Figure 2.

GAINS FROM SERVICES TRADE LIBERALISATION



Source: OECD.

RS 2 billion in 1998 to RS 5.25 billion in 2001. The US and Canada accounted for 30% each of total exports, followed by the UK at 25%.

In **port services**, a number of developing countries feature in the world's top 20 container terminals in terms of throughput, with Singapore, Chinese Taipei, Korea and Hong Kong (China) in the top five.

In **construction services**, 51 of the world's top 150 companies in 2004, measured in terms of the amount of revenue generated outside their home market, were from developing countries, including China, Turkey, South Korea, Brazil and Egypt.

Health services are a major export and source of foreign exchange for a number of developing countries. South Africa has become a major destination for patients seeking plastic surgery. Clinics in Costa Rica report growing numbers of clients from the UK and Norway, as well as Canada and the US. Chile meanwhile receives patients from Bolivia and Peru and to a lesser extent from Ecuador.

The Internet revolution has also made it possible to deliver a wide range of services electronically. This has created a world market for international sourcing of services ranging from remote call centres to sophisticated software development, a growing share of which has been captured by developing countries from Asia to the Caribbean. This can mean cost savings of up to 50% in the long term for companies, thanks to the relatively low cost of highly skilled labour and improvements in telecommunications.

But to take advantage of international sourcing opportunities in any sector, developing countries will need efficient telecommunications, a well-trained workforce and access to developed country markets. At the same time, despite the substantial global benefits from such trade, concerns relating to short-term negative effects in industrialised countries, such as job losses, need to be addressed. ■

What is the role of technology transfer?

Open services markets also increase exposure to foreign technologies. As most new technologies emerge in developed countries, trade can enable developing countries to benefit from international research and development efforts. In many service sectors, foreign providers have helped to transfer new technologies and to build capacity (see Box 1). Technology transfer occurs at many levels: through contracts, through use of newer equipment which incorporates newer technology and through exchange of knowledge and experience between people.

New technologies are essential if developing countries are to play a full part in the global knowledge economy. However, the transfer of technology comes at a cost and depends on the firm at the receiving end being able to adapt to the new technology. Open services markets can help by reducing the cost of technology transfer not only in services sectors, but also in manufacturing and in agriculture. Business services, for example, can help local firms improve productivity and adapt foreign technologies to their needs. Telecommunications, higher education and training, financial and logistics services can all help developing countries to access new technologies and reduce the cost of adopting them.

The evidence available so far makes a strong case for open services markets as a catalyst for technological progress and diversification. A virtuous circle can be created where enhanced trade leads to more technology flows and technology leads to increased trade because it offers new ways of doing business. An emphasis on key services that facilitate the exchange of knowledge between foreign and domestic companies can have a significant impact on technology transfer and economic growth in developing countries. ■

Why does regulation matter?

Reform in services is no easy task, however. The gains from reform will be reduced or may not materialise at all if reforms do not tackle all of the policies that restrict competition. Examples abound of reforms that did not produce the expected benefits because other measures remained in place that allowed firms to collude or to forestall vigorous competition. Reform efforts must also take into account the legitimate role of government to ensure that non-economic objectives, such as universal provision of telecommunications, water or electricity services, are met.

The OECD has in recent years worked in co-operation with the UN Conference on Trade and Development (UNCTAD) to develop tools to help WTO members, particularly developing countries, in the negotiating process. This and other OECD work on public services shows that for service sector reform to contribute to development, *strengthened* regulation and domestic policies will

Box 1.

TECHNOLOGY TRANSFERS THROUGH TRADE IN SERVICES

In **telecommunication services** the number of mobile phone subscribers is higher than fixed-line subscribers in a significant number of developing countries, largely thanks to GSM technology introduced by foreign operators. When the incumbent operator already had a GSM network, the entry of a second (foreign) operator generally triggered lower prices, making the technology available to a larger number of consumers.

In **retail services** in Latin America, large foreign retailers entered into alliances and mergers with local retailers. New technologies and management techniques were introduced and the market evolved from small owner-operated shops to supermarket chains and shopping centres. Local retailers responded by adopting some of the features of the foreign retailers, such as investing in information technology and changing purchasing and pricing strategies.

In Indonesia's **banking industry**, regulatory reforms enabled privately-owned banks to enter the market, but their market share remained limited. Nonetheless, commercial banks enhanced their activities through innovation and by providing new banking services, aided by training programmes run by foreign banks. A significant share of foreign bank-trained employees then moved on to other banks, and domestic banks built similar training programmes.

Aptech and NIIT are two companies based in India that provide **IT training services**. Their clients include leading software companies, such as Microsoft, PeopleSoft and Computer Associates and the two Indian companies also export IT training services to many developing countries. Technology transfer through trade was very important in developing the Indian IT industry and now India is exporting IT technologies to both industrialised and other developing countries.

have to accompany liberalisation. Trends in recent years towards privatisation and more competition in many countries have increased the need for regulation in sectors such as financial services, for example. Governments may need to put in place prudential measures to protect investors or depositors or to ensure the integrity and stability of the financial system.

Recent trends towards private sector participation have also increased the need for a strong regulatory framework in sectors that have traditionally featured limited competition, such as telecommunications, energy and environmental services. New regulatory tools and approaches are needed for pricing, universal access and service standards. Access for the poor is also critical for other basic services such as health and education, but so is consumer protection and quality of service. Buyers of services are often inadequately informed about individual service providers, such as universities.

At the same time, regulatory reforms must be designed carefully to ensure that public policy objectives continue to be attained in an efficient manner. A study on legal services undertaken by the OECD as part of its work with UNCTAD, for example, shows that trade restrictions are not the only way to meet social objectives in the sector such as ensuring consumer protection, professional competence and local knowledge. Measures such as requiring legal service providers to collaborate with local people, testing their competences and obliging them to take professional liability insurance could meet these objectives equally well, or even better.

Attracting more foreign direct investment (FDI) is often the best way to enhance competition in services industries, but privatisation and foreign take-overs of domestic firms may also give rise to excessive market power and monopolistic pricing. So governments may need to set new competition rules at the same time as opening up trade and investment. Performing all these tasks effectively requires strong, independent regulatory agencies and competition authorities. Such institutions can be costly to set up and run. They also require sophisticated skills and therefore present challenges that are likely to be more acute in developing countries. Technical assistance and capacity building are thus particularly important for these countries.

Similarly, appropriate domestic policies may be needed in both sending and receiving countries to address migration concerns related to Mode 4, including overstaying, brain-drain and general social questions such as cultural issues or lack of respect for social and labour rights. OECD work, in co-operation with the World Bank and the International Organisation for Migration, finds that most of these concerns are manageable, given the political will and appropriate policy responses. A number of countries are successfully combating overstaying, by mobilising resources to monitor temporary entries and by focusing on employers' obligations when they sponsor people coming in. Sponsors need to co-operate with government monitoring and be held responsible for workers' return travel. They also need to know that they may face sanctions if they break the rules.

Social concerns about brain-drain can be minimised with policies that foster social support and brain-circulation – encouraging migrants to return home with their newly acquired skills and experience. Evidence from bilateral agreements suggests that the most sustainable temporary migration programmes are those that are appropriately regulated and enforced, and which offer flexibility through economic and social incentives. Perhaps the most important incentive is to allow migrants who return home to re-enter the receiving country in the future for business opportunities.

Better management of remittances can be crucial in creating an environment that encourages people to return. Programmes that support small and medium-size enterprises in countries of origin can be particularly beneficial, as is the establishment of remittance-friendly fiscal rules or community funds. Co-operation between sending and receiving countries and co-ordination between trade and migration officials at the national level is the most effective basis for obtaining significant results in terms of migration control and management. ■

What are the key negotiating challenges for developing countries?

The complexity of liberalising services trade under the GATS should not be underestimated, particularly in light of the limited administrative and negotiating capacity of many developing countries. A country needs to gather significant knowledge before it can submit sensible market opening requests and offers. This includes identifying opportunities and challenges for its exporters, determining its capacity building needs and assessing the likely social impact of liberalisation.

Preparing for the negotiations thus requires a multi-stakeholder approach involving all relevant governmental agencies (and negotiators), legislators, regulators, business and civil society. Mechanisms for co-ordination and consultation are critical to put forward a coherent view that represents the best possible national position. This is particularly true for services, given the wide variety of sectors, modes of supply and regulatory spheres involved.

Such mechanisms are often lacking in developing countries. Yet an OECD-UNCTAD survey undertaken recently in a number of industrialised and developing countries, as well technical assistance missions undertaken by the OECD, show that developing countries are making real efforts to effectively prepare for the negotiations. Country and region-specific impact assessment studies are being undertaken throughout the world to investigate the potential economic and social effects of liberalising key sectors under negotiations and mechanisms for intra-governmental co-ordination and stakeholders' consultation established. But more needs to be done to help developing countries make a success of the current GATS talks. ■

For further information

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For further reading

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The OECD Policy Briefs are prepared by the Public Affairs Division, Public Affairs and Communications Directorate. They are published under the responsibility of the Secretary-General.

00 2005 4 N 1 P 4

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